No. 15726

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALBERT J. FIHE, ELIZABETH M. FIHE, Husband and Wife,

Petitioners-Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

APPELLANTS' OPENING BRIEF.

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I.
STATEMENT OF THE CASE.

This appeal comprises a petition to review a decision of the Tax Court of the United States.

One of the disputed questions before the Tax Court was whether or not a true partnership existed between the two Petitioners during the greater part of the year 1946. Petitioners filed separate returns and paid their individual taxes as members of the partnership for the year 1946. The Internal Revenue Agent contended that there was not a true partnership, but after the trial, the Director of Internal Revenue conceded this point and submitted revised computations.

Accordingly, the remaining questions now before this Court relate specifically to improperly imposed penalties, unwarranted disallowances of deductions by the taxpayers, arbitrary assessments against the taxpayers and improper and very peculiar bookkeeping methods employed by the successors of the partnership, which showed income never received by the Petitioners.

II.
ABSTRACT OF THE FACTS.

Petitioner Albert J. Fihe is a practicing lawyer, specializing in patents and trademarks, having opened an office in Chicago in 1922 [R. 48]. Now operating in Burbank [R. 213].

In the year 1936, Albert obtained a patent on a hamburger patty molding machine for Harry Holly of Chicago [R. 171]. The invention appeared to have some merit and the Fihes (Albert and Elizabeth) financed Holly in the manufacture and distribution of these machines through eight or nine very lean years, contributing about eight or nine thousand dollars annually [R. 172]. The greater part of this money was contributed by Elizabeth.

Up to January of 1945, the partnership consisted of the inventor Holly and Albert Fihe. At that time a four party partnership was organized which included the wives of the two original partners, Elizabeth having insisted that she have a vested interest because of her cash investments and considerable work in the business [R. 172, 176]. In the years 1945 and 1946, the business

finally began to show a profit, and on September 25, 1946, an Illinois Corporation known as Holly Molding Devices, Inc. was organized, each of the four partners receiving fifty shares namely, one-fourth of the stock [R. 170 and 207].

Sometime in the spring of 1946, while Petitioner Albert was away on a business trip, Harry Holly, together with an internal revenue agent and the company's auditor, conspired to defraud the Government out of approximately $3,000.00 in income taxes [R. 204], upon condition that the agent would receive $1,000.00 in cash and the auditor $500.00, which money was to be contributed by Holly and Fihe.

Fihe, upon returning from the trip, was advised of the proposed arrangement but refused to have any part of it [R. 205].

Holly insisted upon proceeding, whereupon Albert reported the whole matter to the Internal Revenue Agent in Chicago, who called in the Federal Bureau of Investigation. These people furnished Albert with some marked money to give the Agent, which he did, much against his will, and only after considerable pressure by the F. B. I. and their insistence that he perform his duty as an honest citizen [R. 206]. Holly, the auditor and the agent were all convicted and served terms in federal penitentiaries.

As a result of consequent ill feeling, Albert and Elizabeth sold their stock in the Corporation for $100,000.00 and moved to California in 1948.

Also, as a result, your Petitioners have, ever since that date, been the object of a great deal of investigation, and what might actually be termed persecution, by internal revenue agents, both in Chicago and Los Angeles. A great deal of this activity comprised continued expressions of disbelief of the taxpayers returns, persistent requests for attendance at investigative hearings, one of which required the presence for an entire week by Albert in the offices of the Collector of Internal Revenue in Chicago [R. 208].

Another result was the reconstruction in the year 1948 of the Holly corporate books by a firm of certified public accountants. These people, without the knowledge of the Fihes, completely revised the 1947 financial statements of the Corporation and included many debits against the personal accounts of both Albert and Elizabeth varying in amount from $20.00 to $10,000.00, practically all of which were entirely unwarranted and with no foundation whatever, as shown by the record. Petitioners deeply resent being taxed on these false and fictitious records, which show income they did not receive.

These facts comprise the main reasons for this appeal; namely persecution and penalizing of honest citizens by the Director of Internal Revenue because of having reported his crooked agents. Furthermore, Harry Holly, having served a term in the penitentiary, because of Fihe, apparently instigated the manipulation of the corporate books in the hope of revenge.

III.
SPECIFICATION OF ERRORS.

Heretofore, Petitioners have specified, for the transcript, a summary of the errors which they urge [R. 76], as follows:

1. The Honorable Judge of the Tax Court erred in holding that Petitioners understated their business income for the years 1947 to 1949, inclusive, and the Court erred in not allowing itemized and proper deductions in each of said years.

2. The Honorable Judge erred in holding that Petitioners understated income derived from the corporation known as Holly Molding Devices, Inc., of Chicago, Illinois, for the years 1947 and 1948. Petitioners assert that the corporate records were deliberately changed and falsified after Petitioners sold their interests and stock in the company.

3. The Tax Court erred in taking into consideration the fact that the then president of Holly Molding Devices, Inc., namely Harry H. Holly, was an ex-convict, having served a term in the federal penitentiary for attempted income tax evasion and also for actual bribing of an internal revenue agent. The statements and records of such a person should not be given precedence or preference over the word of a reputable attorney, sworn to uphold the Constitution, especially as he had actually reported Holly's wrongdoings to the Federal Bureau of Investigation and the Internal Revenue Department.

4. The Judge of the Tax Court erred in holding that the Petitioners did not invest at least $35,000.00 to $50,000.00 in the corporation's predecessor partnership known as Holly Molding Devices during the ten years of 1936 to 1945, inclusive, and in ruling that the Petitioners realized a long term capital gain of about $80,000.00 when selling their stock in the corporation in 1948. Petitioners' profit was not over $50,000.00, and was distributed over several years.

5. The Judge erred in assessing a negligence penalty against the Petitioners for each of the years 1946, 1947 and 1948, regardless of the fact that Petitioners at the trial submitted books of record showing careful and individual entries for all their business transactions for the years 1947, 1948 and 1949, which corresponded with their returns for those years.

6. The Tax Court erred in ruling that the non-negotiable notes which Petitioners received when selling their stock in the corporation represented actual cash and taxed Petitioners accordingly. Payments on these notes extended over a period of more than three years, and taxes should accordingly have been so distributed. The Court erred in taxing the Petitioners on the entire sum in the year 1948, although payments were never assured and could not have been collected by Petitioners under any circumstances in the one year of 1948.

7. The Court erred in determining a tax deficiency against the Petitioners of approximately $7,000.00 for the year 1948, when, in fact, Petitioners experienced and reported a business loss of over $20,000.00 in the year 1950, which should be applied as a carry-back to the year 1948. Petitioners' profits for 1948 were not substantial in any event.

8. The Judge erred in not recognizing the proven fact that Petitioners saved the United States Government untold sums of money in reporting the wrongdoings and fraudulent actions of Harry H. Holly, his company auditor and the Internal Revenue Agent conspiring with them. The honesty and integrity of the Petitioners have been proven to be above reproach and any reasonable doubt should be resolved in Petitioners favor.

The foregoing specification of errors will be fully developed in the argument section.

IV.

PROCEEDINGS BEFORE THE LOWER COURT.

A great deal of the trial proceedings related to proof by the Petitioners that a true partnership existed, so far as Albert and Elizabeth were concerned. This was important, because the Commissioner of Internal Revenue had, under date of January 14, 1954 [R. 7] advised Petitioner Albert that he would not recognize the partnership status and accordingly transferred an amount of $13,663.34 from income reported by Elizabeth for the year 1946 to Albert's account, rendering a deficiency of income tax in the amount of $9,515.06. He also arbitrarily added a 5% negligence penalty of $475.75.

After incontrovertible proof at the trial, the Commissioner conceded that a true partnership existed. Accordingly a great deal of the evidence adduced at the trial need not now be considered.

V.
ARGUMENT.

A. Facts and Law.

The remaining questions before this Honorable Court are almost all strictly factual, and there is no point in citing many legal decisions, because they would have little bearing on the situation.

So far as the actual questions are concerned they can be stated as follows:

B. The Year 1946.

A revised computation of tax against Albert and Elizabeth Fihe for the year 1946 is now set up by the Commissioner as follows: Albert J. Fihe, 1946 Deficiency $2,826.87—negligence penalty $141.34 [R. 34]. Elizabeth M. Fihe, 1946 Deficiency $2,687.00—negligence penalty $141.34 [R. 35].

It will be noted that Petitioners each paid a tax for the year 1946 in the amount of $1,463.08 [Resp. Ex. C] and the additional sum of $2,826.87 is contended by the Commissioner to be a deficiency. This is unreasonable and not substantiated. Petitioners however, have tentatively agreed to an additional tax of $826.87 each [R. 40], and have indicated their willingness to pay this. However, as the 1946 returns were prepared by a firm of certified public accountants [see Resp. Exs. H and I] any penalty for negligence is absolutely and wholly unwarranted. These unreasonable penalties comprise one of the reasons for this appeal.

C. The Year 1947.

The Commissioner of Internal Revenue disagreed considerably with the Petitioners joint return for the year 1947 and decided that they had an additional income for that year of $27,306.48 [R. 21]. Petitioners disagree with this in every respect, but inasmuch as there is a carry-back allowance from losses sustained in the year 1949, with a resultant deficiency assessment of only $397.40, Petitioners have tentatively agreed to pay this, inasmuch as it is hardly worth this Court's time or that of anyone else. However, Petitioners emphatically dispute the 5% penalty of $533.78 arbitrarily assessed by the Commissioner and acquiesced in by the Tax Court. In this case, as in the year 1946, the Petitioners returns reflected absolute concurrence with the Corporation income tax return for the year 1947 [Resp. Ex. J]. This return was prepared by a firm of certified public accountants and there is no reason why Petitioners should be penalized in any respect for such a return.

D. The Year 1948.

In this year lies the main "bone of contention."

First, Petitioners sustained a considerable loss in the year 1950, which, if properly computed as a carry-back, would eliminate any tax for this year [R. 213].

Second, the Commissioner of Internal Revenue and also the Tax Court both gave great credence to the bookkeeping methods employed by the corporation during that year, wherein considerable sums were charged to the Petitioners' accounts, with absolutely no basis whatever.

For example, in the deposition of Respondent's witness Wiscons there was shown a charge against the account of Albert Fihe in the amount of $11,920.00.

Upon being asked on cross-examination, as to the origin of that charge, the witness said "I do not know that. I do not know." [R. 138]. He also admitted that this was a pencil notation.

Upon further cross-examination, the following transpired [R. 153]:

> "Q. (By Mr. Fihe): Your accountants made the entries, did they not? A. Not the payroll entries.
>
> Q. No, I mean that last thing—this $11,000 in the ledger? A. The accountants had, I believe, given us the entries to make.
>
> Q. And they are just in pencil at the bottom of that page? A. On this one here (indicating).
>
> Mr. Levin: Let us identify the book.
>
> Mr. Fihe: I am talking about my own page with my name at the top showing payroll checks.
>
> The Witness: That is my writing.
>
> Q. (By Mr. Fihe): It is in pencil? A. Yes.
>
> Q. Who told you to do that? A. It was set up from the general ledger book to the payroll book.
>
> Q. Who told you to do that? A. I would assume the accountants at that time. No one else knew anything about it, outside of yourself and Mr. Bornstein.*
>
> Q. Who was the accountant? A. Barrow, Wade & Guthrie.
>
> Q. You mentioned Mr. Bornstein. He was your auditor in 1946 and early 1947, was he not? A. If you can call him an auditor. He used to come in and check the books. I do not know.

---

*Bornstein was the company auditor who conspired with Holly and the Internal Revenue Agent to defraud the Government.

Q. Don't you know he went to the penitentiary for attempted income tax evasion?

Mr. Levin: I object on the ground that the question is immaterial and irrelevant.

The Witness: I believe I heard of it."

Fihe personally testified that he never received such a sum [R. 224-236]. There were many other charges against the accounts of Albert and Elizabeth Fihe made in the year 1947, which this witness could not explain [R. 143, 145, 149, 150, 151].

Wiscons testified that as of October 1, 1946, the books showed liabilities from the corporation to Petitioner A. J. Fihe in the amount of $4,661.49 and to Petitioner E. M. Fihe in the amount of $3,461.29 [R. 85]. Both Mr. and Mrs. Fihe testified, under oath, in Court that they never received that money [R. 167, 211].

As stated by A. J. Fihe, in his testimony, someone in the Holly organization, or their accountants or auditors, took it upon themselves to completely revamp the books which were kept by Petitioner up to the end of 1947. These changes showed quite a bit of money either charged to the Fihes' account or showing money that was presumably paid to them and which they did not get [R. 211].

This is borne out by the very vague and wholly unsubstantiated testimony of Wiscons (Respondent's own witness) who repeatedly stated with regard to amounts charged to the Fihes that there was no explanation therefor. Here the witness said "I am afraid I cannot answer that. I don't know just how these things were set up at that time. There are some entries here which credit Mr. Fihe on journal entries and there are also some journal entries that charged the personal account." [R. 89, 222.]

Again [R. 90]:

"Q. Is there an explanation as to that amount? A. Let's see. No sir, all there is is a check made out November 1 for $500.00 to Mr. Albert J. Fihe and a check on November 25, 1946 made payable to Mr. Albert J. Fihe for $2,000.00. * * * There is an entry in our general ledger as of January 31, debiting Mr. Albert J. Fihe for $1,000.00.

Q. Is there any explanation as to that amount? A. No sir. There is just a check issued on January 10 in the amount of $1,000.00 and charged to the account of Albert J. Fihe. * * * March 31 there was a debit of $800.00 to the account of Mr. Albert J. Fihe.

Q. Is there any explanation for that amount? A. No, there isn't."

On page 97 of the Transcript the following appeared:

"A. April 30, 1947: We have two entries in our general ledger to the account of Mr. Albert J. Fihe; one in the amount of $3,725.00 and the other in the amount of $3,000.00 even.

Q. Are there any explanations for these amounts? A. The one for $3,000.00 has an explanation. It was written to Mr. A. J. Fihe, and the explanation is 'loan from corporation'."

As testified by both the Fihes in Court, the corporation never lent either of the Fihes any money. It was the other way around [R. 172, 211, 243].

There was another item marked "loan from corporation" in the amount of $2,600.00. As Fihe explained [R. 58] this was for legal fees paid for the defense of H. H. Holly in the criminal suit against him wherein he was convicted of bribing an Internal Revenue Agent.

Again [R. 92]:

> "The other amount of $3,725.00 was issued in the form of three checks, two of them in the amount of $700.00 each, and one in the amount of $2,325.00 even.
>
> Q. Do those contain any explanation? A. Those last three, no, sir."

The Fihes testified that they had never borrowed from the company but that they continually advanced considerable funds to keep the company going [R. 156, 171].

The Witness Wiscons also mentioned many other items presently appearing on the books of Hollymatic Corporation and which were dated back to the time that Petitioners were active in the business of its predecessors. For example [R. 90] there is a debit on the books dated November 30, 1946, to the account of Albert J. Fihe in the amount of $2,500.00 with no explanation, a debit of $1,000.00, no explanation, also in the same page a debit of $800.00 with no explanation [R. 91].

On page 95 of the Transcript there is shown a lot of entries, mostly charges against the Petitioners, the only explanation being "to transfer advances to officers to proper accounts." As the Petitioners testified, there were no advances to officers at any time. There was some division of profits to the partners, there was some rent collected by the four partners on real estate owned by the partnership, there were salaries paid and there were some repayments of loans, but never any advances [R. 211].

The witness testified regarding some entries [R. 97], one of which is a debit to the account of Albert J. Fihe for patents. If anything, this should have been a credit for patent work which was freely given the corporation

and no monetary charge was made at any time, all as substantiated by the evidence in Court [R. 248].

The amount of $3,632.05 stated by Wiscons to have been paid to A. J. Fihe on June 25, 1947, is actually about the only correct amount listed in all his depositions. This was a partial payment on a loan and was properly credited on the notes given Albert J. Fihe by the original partnership [Pet. Ex. 10]. On September 30, 1947 [R. 101], there was a charge to A. J. Fihe in the amount of $5,-890.00. As explained in Court, this was a check given Fihe for his office furniture which he sold to the corporation and upon which the corporation later reneged. The actual payment was explained by Fihe [R. 201]. It is noted that the reporter stated the amount as $8,090.67 but Petitioners' Exhibit 12, which is the actual bill of sale and is in evidence here, shows that the amount was only $890.67. Fihe lost $5,000.00 on this transaction alone [R. 167].

Also, on page 149, the following occurs:

> "Q. (By Mr. Fihe): I believe you testified that your records showed I was paid three weeks salary in the beginning of 1948 at $400 a week, amounting to $1,200. Then you went on to testify that your records showed there was a further charge against me of $981.90; and it was charged for salary. Can you explain how—when I resigned as president of the corporation as of the first three weeks of 1948—I drew any more salary after that, having completely severed my connection with the corporation? A. I do not know how you could have drawn any more."

Fihe himself testified in Court that the books were not in their present condition when he had charge of them, and further stated that the accountants, Barrow, Wade & Guthrie, performed some really unusual feats of bookkeeping [R. 222; Resp. Exs. K and L].

Also, the Commissioner and the Court would not agree that the Fihes invested any more than approximately a total of $20,000.00 in the partnership business over a period of almost ten years, while the uncontradicted sworn testimony of both the Petitioners in Court shows that the combination of loans, investments and other advances was much greater, namely around $45,000.00 or $50,000.00 [R. 193].

Obviously, if the Fihes received $100,000.00 for their half of the business, the entire business was worth $200,000.00. It is beyond the realms of possibility that a $200,000.00 business could be built up from an initial investment of only $20,000.00 (the Commissioner's figure), especially when the first ten years of the business constituted a continuously losing operation [R. 159].

As an alternative and possibly a very accurate estimate of the contributions to the partnership by the Fihes over the years, it will be noted that the total assets at the time that the corporation was organized amounted to $32,698.28. Finding of Fact [R. 67].

It being obvious that neither one of the Holly's had, at any time, any money to invest, this sum of $32,698.08 is a very fair representation of the amount contributed

by the Fihes, and is respectfully requested that this Court consider this as a basis for figuring the long term gain on the final selling price of the stock owned by the Fihes. This would leave a long term gain of $67,301.72.

Another question regarding this long term gain is whether it should all be computed in the one year of 1948 or spread over two or three of the succeeding years as the Petitioners contend.

It happened that the Petitioners did, through the years 1949 through 1951, erroneously report this long term gain as income, but inasmuch as they lost money in each of those years there was no tax in any event [R. 213].

Petitioners still insist that inasmuch as the notes which they received in part payment of their stock were not negotiable, the entire profit cannot properly be taxed against them for the year 1948. Of the approximate $100,000.00 received by Petitioners when selling out, $25,000.00 was received in cash, $5,000.00 was arbitrarily charged to the account of A. J. Fihe but never paid to him [R. 125, 201] and the remainder of $70,000.00 was in the form of notes, payable to the individual Petitioners, totaling $1,750.00 monthly for forty months, plus interest. These notes were written so as to specifically exclude the words "OR ORDER" [R. 225] from each, making them non-transferable and non-negotiable. Fihe testified that the notes themselves had no actual value, regardless of the chattel mortgage, because the chattel mortgage itself was worthless [R. 243]. Inasmuch as the notes were not negotiable and that the Fihes could not have at any time realized any money from them or even sold them to anyone, the transaction was, therefore, not completed in the year 1948, but was a continuing matter until the last note was paid in 1951.

Such non-negotiable notes have always been considered by the Courts as having no fair market value. (See *Humphrey,* 32 B. T. A. 280, also *Mary T. Smith,* 4 T. C. Memo. 440.)

Even assuming that the Commissioner and the Court were correct in holding that the entire long term capital gain should be assessed in one year, the following computation based on an original investment of $32,698.28 should apply.

Computation of tax for 1948, considering all disallowances but figuring long term capital gain on amount actually received in that year from sale of corporate stock.

Admitted net business loss as shown by agent's report		$ 6,698.08
Less exemptions (add)		1,800.00
Joint income subject to tax (loss)		$ 8,498.08
½ long term capital gain	$41,500.00	
Less original investment as recognized by Court [R. 25]	20,595.37	
	$20,904.63	
Net income		12,406.55
$68.00 + 12% of excess over $400.00		1,508.72
Less withholding taxes paid on salary		206.70
Total Joint Tax for 1948		$1,302.02

Another manner of computing would be to consider the original Fihe investment as only $20,595.37 [R. 25], which then produced a long term capital gain of $79,-

404.63; but recognizing the fact that the disallowances by the Commissioner were improper, the following will apply.

Disallowances eliminated:		
Interest	$ 235.40	
Tax	511.29	
Damage and Theft Losses	3,362.44	
Legal Expense	561.75	
Freight	1,124.45	
Stationery	150.00	
Travel Expenses	5,802.97	
Commissions	800.00	
Advertising	598.14	
Repairs	74.57	
Postage	243.33	
Telephone and Telegraph	71.53	
Depreciation	1,986.58	
Contributions	373.23	
Total	$15,895.68	
Net loss as shown by return		$22,593.76
Less exemptions (add)		1,800.00
Joint income subject to tax (loss)		$24,393.76
½ long term capital gain		39,702.35
Net income		$15,309.39
Tax computation:		
$68.00 + 12% of excess over $400.00	$1,857.08	
Less withholding	206.70	
Joint tax for 1948	$1,651.38	

It will be noted that either method of computing the tax results in an amount much less than that arrived at by the Commissioner and concurred in by the Court.

Furthermore, if a more reasonable application of original investment is made, namely the sum of approximately $32,700.00 [R. 67] as against approximately $20,000.00, the tax on the joint return for 1948 would, in either case be only about one-half of that computed above.

It is again respectfully pointed out that if a carry-back loss from the year 1950 be applied, there would be no tax whatever against the Petitioners for the year 1948.

Albert commented briefly regarding some of the very unfair disallowances made by various agents when checking his returns. For example, a deduction of $92.00 for contributions in the year 1947 was completely disallowed by the Agent [R. 210]. An item of $19.00 for medical expense was disallowed [R. 209]. Such actions were indicative of the antagonistic, belligerent and entirely unreasonable attitude of one or more of the agents or their superiors. For the year 1948, contributions were disallowed in the amount of $373.23, traveling expense in the amount of $5,800.00 was disallowed, advertising in the amount of $598.00 was disallowed. Depreciation in the amount of $1,986.58 was disallowed [R. 50]. As Fihe explained, he had, upon moving to California, bought a small factory and some used machinery, upon which extensive repairs were necessary and a considerable amount of depreciation was taken on both the real estate and the machinery, which it is believed is very reasonable under the circumstances [R. 213].

Fihe, in his testimony, commented upon the disallowance of a loss claimed for damages to his household furniture when he moved from Illinois to California in the year 1948. This was claimed as $3,362.44 and both witnesses testified fully regarding the same, none of which has ever been recovered [R. 212]. The disallowance of this entire amount was wholly uncalled for. Freight charges for moving both household and office furniture to California was also disallowed *in toto*. Traveling expense in the amount of $5,802.97 was disallowed completely, although all of it was for business purposes, as also the item of $800.00 for commissions. The total deductions disallowed for the year 1948 was $15,522.45 [R. 50], which, as Fihe testified, was most peculiar in that he had arrived at what he thought was a reasonable adjustment of these items following work with the Agents in Chicago for an entire week. Fihe traveled from California to Chicago for that purpose alone and paid all expenses and gave freely of his time for the period. Regardless of this and the oral agreements, the written report completely reversed practically all of the agreed upon matters for all four years [R. 208].

E. The Year 1949.

As Fihe also testified with regard to the year 1949, deductions in the amount of over $10,000.00 were disallowed as either personal items or duplications, although originally allowed in the conferences in Chicago. Fihe testified that all these deductions were proper and fully accounted for [R. 212-213].

Also, relative to the year 1949, Fihe testified [R. 214]:

> "I spent a terrific amount on advertising in the year 1949, trying to promote the sale of that fishing reel. The agent disallowed $2,000.00 of it.

"I did a lot of traveling; the agent disallowed $1,-900.00 of traveling expenses. He disallowed interest which I had paid on loans in the amount of $600.00. The agent disallowed postage in the amount of $249.00. How can a business operate without spending money for postage and that is only $20.00 a month, which I think is very reasonable."

Travel expense in the amount of $1,983.17 was disallowed for 1949. The Tax Court should have taken judicial notice of the fact that a patent lawyer, such as the Petitioner here, must inevitably travel a great deal and certainly more than other lawyers; and as Petitioner Fihe himself testified, practically all of the entire amounts disallowed were verified by vouchers, cancelled checks or other records made at the time [R. 214].

Medical expenses in all the years in question were practically wholly disallowed, although proper proof of same was submitted. In fact, the amount claimed for medical expenses in the year 1949 was $1,089.34 and the Agent quite arbitrarily disallowed the entire sum [R. 212]. Petitioners, with not only their own status in mind, but also that of other taxpayers, cannot in good conscience permit such complete and outrageous disregard of their constitutional rights.

Our United States Supreme Court has said that "Anyone may so arrange his affairs that his taxes shall be as low as possible. He is not bound to choose the pattern which would best pay the Treasury. It is not even a patriotic duty to increase one's taxes." (*Bullen v. Wisconsin,* 240 U. S. 625-630.)

F. Penalties.

The Agents arbitrarily affixed negligence penalties. As explained by Albert, and as brought out in his cross-examination, complete books and records were kept by the Petitioners at all times and were always available for inspection by Respondent's Agents. Fihe explained that he had spent a solid week in the Internal Revenue Offices in Chicago in an effort to arrive at a reasonable conclusion of the alleged differences for the period in question here [R. 209]. It was further explained that the account book kept by the Petitioners, together with all the other records, including cancelled checks, and which were brought into Court at the trial, had been available to the Agents in Chicago and Los Angeles at any time that they requested. The account book was described in detail [R. 208 and 234]. Certified Public Accountants prepared the 1946, 1947 and 1948 returns [Resp. Exs. H, I and J].

Fihe testified that Agents from both Chicago and Los Angeles had inspected that book and all the other records produced at the trial. Also, as will be evident from the returns, the Petitioners operated on a cash and not an accrual basis and kept very simple check book records of receipts and disbursements, together with a careful distribution of those items. An annual summary of same, with substantiating records, obviously suffices for any purpose, audit or otherwise. There was no negligence and there should be no penalty.

Fihe further stated [R. 208] "There are some penalties assessed against both Mrs. Fihe and me for negligence in keeping our books. In our protest, we naturally disagree with those penalties. We believe that we kept our books in good shape. In fact, I have here a record of

all of our transactions during those years and I believe that Mr. Propeck, the agent here, has gone through that book very carefully. Well, somebody from this office has indicated negligence but I know that somebody from the Commissioner's office has been through that book. I am positive of that because he came out to my office at Burbank and stayed there for two days. I don't remember whether it was this gentleman or not."

Also [R. 214]: Frankly, in summing up, your Honor, I am convinced in my own mind that we paid our taxes, try to do my duty as an honest citizen. I think the record will show that I have done so, and frankly I have gone about my duty in reporting what happened.

G. Conclusion.

This Court's own decisions substantiate Petitioners' contention that the notes received when they sold their interest were not negotiable, and that therefore, the proceeds thereof cannot be taxed all in the year 1948 but should be distributed up to and including the year 1951; also as capital gains, not income.

The evidence also proves that Petitioners were more than reasonable in their claim of an original investment of $35,000.00 for which they received $100,000.00 when selling. The testimony indicates that the original investment was more nearly $50,000.00 [R. 172].

The tax returns submitted by the successor of the original partnership appear to be an attempt to render the Petitioners liable for taxes on almost double the sums which they actually received and to save some taxes themselves [Exs. H to M, incl.].

The disallowances by various agents of practically all of the deductions claimed by Petitioners over the years

involved were unfair and actually ridiculous in many instances. Petitioners submitted proper returns, paid their taxes, did more than their duty as honest citizens in reporting the conspiracy to defraud the Government, and should be praised, rather than censured and punished.

The Commissioner and the Internal Revenue Agents insisted, to the bitter end, that no true partnership existed between the Petitioners here. After conclusive proof in Court, they meekly conceded that important point. They still insist on unwarranted disallowances of proper deductions and insist upon assessing terrific penalties, alleging negligence. As here pointed out, the Tax Court should not have upheld these unreasonable disallowances and penalties. Apparently, the Tax Court believed the testimony of an employee of an ex-convict and put considerable faith in the records of a corporation, of which this ex-convict is the President.

The testimony, in open Court, of the Petitioners, who have proved themselves honest and upright, and who actually caused the conviction of Holly and those who conspired with him to defraud the Government, should certainly have more weight with any tribunal.

The fact that these Petitioners did much more over and above their line of patriotic duty in reporting these conspirators, should be carefully considered by this Honorable Court in deciding the issues here presented.

May 7, 1958.

Respectfully submitted,

ALBERT J. FIHE,

Attorney for Petitioners-Appellants.

APPENDIX.

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